UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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ADMINISTRATIVE PROCEEDING
File No. 3-17387

In the Matter of

DONALD F. ("JAY") LATHEN, JR.,
EDEN ARC CAPITAL
MANAGEMENT, LLC,
and EDEN ARC CAPITAL
ADVISORS, LLC

Respondents.

DIVISION OF ENFORCEMENT'S POST-HEARING REPLY BRIEF

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PRELIMINARY STATEMENT

Respondents' arguments and defenses are supported by neither law nor fact. Their argument that advice from multiple lawyers negates scienter is belied by the fact that Lathen neither sought, nor received, advice on his disclosures to issuers. That fact alone debunks Respondents' advice-of-counsel defense. The general advice Respondents received was that they had to be forthright in their dealings with third parties. They did not follow that advice. And none of the ancillary advice received on other topics – such as Lathen's joint tenancies or other aspects of the Fund – revives Respondents' advice-of-counsel defense.

To the contrary, Lathen's interactions with counsel prove Respondents' fraudulent intent and refute their purported good faith. Lathen's partial disclosures to counsel, lawyer shopping, and disregard for advice he disliked demonstrate that he consulted lawyers so that he could point to their presence to entice investors and to provide cover once he got caught, without meaningfully seeking or relying on their advice at the time.

Respondents' other arguments are similarly meritless. Respondents' argument that their brokers are to blame for their own misleading statements is unavailing under Janus and its progeny. Their argument that they didn't have to speak fully because there was no such explicit requirement in the prospectuses is wrong both because it ignores the requirements of the securities laws (which compel complete and accurate disclosures in securities transactions regardless of the terms of any purported contract) and misstates the requirements of the governing prospectuses. And Respondents' argument that any misleading statements were not material ignores the host of issuers who took the stand to say they were, as well as Respondents' own contemporaneous statements.

ARGUMENT

I. RESPONDENTS' ARGUMENTS AND DEFENSES DO NOT UNDERMINE THE DIVISION'S FRAUD CLAIMS

A. Respondents Do Not Assert a Valid Advice of Counsel Defense

Respondents make no claim that they requested or received advice on their disclosure obligations to issuers under the securities laws. (PFOF¶¶651-52;654.) That is fatal to their defense. Respondents' attempt to resuscitate the defense by pointing to advice on the validity of the joint tenancies or disclosure obligations to Participants or brokers is a red herring. In any event, they have not proven their arguments on those side issues.

When Respondents sought advice, Lathen provided curated disclosure of facts to his attorneys, lied about other facts, and ignored advice he disliked. Rather than negating Respondents' scienter, Respondents' attorney communications establish it. Lathen understood he was hiding material facts from the issuers, and sought advice on limited topics that he hoped would provide cover if he was caught.

To establish an advice-of-counsel defense to a scienter-based violation, "a respondent must prove that he: '(1) made a complete disclosure to counsel; (2) requested counsel's advice as to the legality of the contemplated action; (3) received advice that it was legal; and (4) relied in good faith on that advice.'" Matter of Timothy S. Dembski, Rel. No. 33-10326, 2017 WL 1103685, at *11 & n.42 (SEC Mar. 24, 2017) (quoting SEC v. Savoy Indus., Inc., 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981)). Establishing each element does not preclude a finding that Respondents acted with scienter; reliance on counsel is but one factor for consideration. Savoy Indus., 665 F.2d at 1314 n.28; Markowski v. SEC, 34 F.3d 99, 105 (2d Cir. 1994); cf. Matter of Arthur Lipper Corp., Rel. No. 34-11773, 1975 WL 163472, at *8 (SEC Oct. 24, 1975), aff'd, 547 F.2d 171 (2d Cir. 1976) (advice of counsel can be a "mitigating factor"). Respondents do not even attempt to

demonstrate that they satisfied each of these elements for each of the five law firms, or lawyers, they consulted: Grundstein, Domina and Tractenberg from Katten Muchin & Rosenman; Hood from Wiggin & Dana; Roper from Gersten Savage; Flanders, and then Farrell from Hinckley Allen; and Galbraith.

(1) Lathen Hid Material Facts from Counsel

A client cannot rely on advice from a lawyer before whom he does not "fully and honestly la[y] all the facts." United States v. Colasuonno, 697 F.3d 164, 181 (2d Cir. 2012) (quotations omitted); see also SEC v. Johnson, 174 F. App'x 111, 115 (3d Cir. 2006) ("defense is available, however, only when all pertinent facts are disclosed to the professional"); SEC v. Prince, 942 F. Supp. 2d 108, 139 (D.D.C. 2013) (client must disclose all "relevant information").

Lathen sought no advice on his disclosures to issuers, and he provided his redemption letters to no lawyers. (PFOF¶¶651-52;654; see also ¶¶690;752;753; 824;862,863;1017.)[1] He failed to do so even though at least two lawyers—Domina in 2009 and Farrell in 2012—warned him of the care he should give to disclosures, with Farrell even advising that Lathen should make complete disclosure to all third parties of the nature and intent of his program. (PFOF¶¶741-42;889-92.) Where, as here, Respondents received general warnings about misrepresentations, but do not show their disclosures to counsel, they cannot claim reliance on counsel. Matter of Charles K. Seavey, Rel. No. IA-2119, 2003 WL 1561440, at *3-*6 (SEC Mar. 27, 2003), aff'd, 111 F. App'x 911 (9th Cir. 2004) (advice-of-counsel defense failed where lawyer warned respondent not to make misrepresentations, but never saw respondent's disclosures).

Nor did Lathen make full disclosure on other matters on which he purportedly sought counsel. Lathen sought advice on his legal relationships with the Participants from Katten, but

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[1] PFOF¶¶1016-1038 are the Division's Supplemental Proposed Findings of Fact. "DRRPFOF" refers to the Division's Responses to Respondents' Proposed Findings of Fact.

never provided them his Power of Attorney. (PFOF¶¶712-15.) Lathen sought advice on his joint tenancies from Tractenberg, Katten's Trusts & Estates lawyer—whom Respondents did not call at the hearing (PFOF¶716)—but there is no evidence she was provided a Participant Agreement. (PFOF¶¶698-703.) Before Farrell got involved, Flanders was apparently provided no documents, a fact confirmed by his billing records which reflect no such review. (PFOF¶¶820-822.) There is no evidence that Galbraith, retained in July 2014 to represent Lathen and EACM in the Prospect dispute (PFOF¶¶939-42;944), received either the IMA or the PSA.[2] (PFOF¶¶959-71;1020.)

As Lathen began to appreciate that disclosures to counsel might produce advice that would hamper his conduct, he hid facts from counsel—Farrell in particular. After Farrell advised him that his interest in the joint accounts had to be distinct from the Fund's because, as an entity, a Fund cannot be a joint tenant (PFOF¶¶837;871-76), he agreed to implement a loan structure, as she advised. But, for nine months (PFOF¶904), Lathen failed to forward his new, self-drafted PSA to Farrell, undoubtedly because he suspected her reaction would be that it—like his IMA—made it likely that the Fund was a co-tenant, destroying the validity of his joint tenancies. When Farrell did see it, that was precisely her reaction. (PFOF¶¶905-09.)

Lathen hid unfavorable advice from subsequent rounds of lawyers. Lathen gave Roper, his Fund counsel, materials saying that his investment strategy was blessed by counsel (PFOF¶763), but there is no evidence that Lathen disclosed to Roper (or any other attorneys) that Katten warned

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[2] It is implausible that Galbraith would have no recollection of those agreements if he had considered their impact on his NY Banking Law analysis. See Matter of James A. Winkelmann, Sr., Rel. No. ID-1116, 2017 WL 1047106, at *61 (SEC Mar. 20, 2017), rev. granted, Rel. No. 33-10354, 2017 WL 1832426 (SEC 2017) (rejecting contention that non-testifying lawyer gave respondent oral advice that conduct was lawful where there was no evidence of "some underlying research, analysis, and discussion with [the lawyer]" about the topic). Given his role as litigation counsel and joint defense counsel in this proceeding (PFOF¶¶951-56), Galbraith's views and advice should be accorded limited evidentiary weight in any event.

him not to execute his strategy through a Fund. (PFOF¶¶692-93;719-22.) Most egregiously, there is no evidence that Lathen shared with Galbraith Farrell's advice that the nominee arrangement under the IMA and profit sharing under the PSA destroyed the joint tenancies by making the Fund the true beneficial owner of the accounts. (PFOF¶¶837;871-77;904-09;1011.) If Lathen doubted that advice and went to Galbraith for a fresh set of eyes on joint tenancies, his only purpose in failing to share the IMA and PSA with Galbraith must have been to avoid the same advice that Farrell provided.[3]

(2) Lathen Neither Sought, Nor Obtained, Specific Advice About Disclosure Obligations

The second and third prongs of the defense require Respondents to show that they "requested counsel's advice as to the legality of the contemplated action. . . [and] received advice that it was legal." Dembski, 2017 WL 1103685, at *11. Respondents have failed to show either element with respect to key aspects of their strategy.

Respondents proffered no evidence that Lathen sought or obtained advice about the adequacy of his redemption letters, (PFOF¶654; see also ¶¶690;752;753;824;862;863;1017), nor on his disclosure obligations under the securities laws. (PFOF¶651.) Indeed, Lathen concedes that no lawyer reviewed his disclosures to issuers.[4] (PFOF¶¶651-52;654.) Without such evidence, their advice-of-counsel defense fails.[5]

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[3] Lathen also appears to have lied to Galbraith, telling him that he had not withdrawn funds from the joint accounts (e.g., PFOF¶¶999;1022;1025-29), a claim that Galbraith then conveyed to at least one issuer's counsel. (PFOF¶¶998-1000.)

[4] Lathen cannot rely on newspaper articles he read that purported to quote legal opinions. The advice on which a respondent relies must be from his own lawyer. Matter of Rodney R. Schoemann, Rel. No. 33-9076, 2009 WL 3413043, at *12 & n.42 (SEC Oct. 23, 2009), aff'd, 398 F. App'x 603 (D.C. Cir. 2010).

[5] Flanders' uniformed advice (PFOF¶¶820-822) about what Lathen needed to disclose to issuers is of no help to his defense as it was based on contract, not securities, law. (PFOF¶824.)

That Lathen never sought advice about his redemption letters is evidence itself that he knew they were inadequate. If he truly sought to pursue his strategy in "an appropriate manner" (PFOF¶1033), why wouldn't he seek advice on that key aspect of Respondents' strategy? He knew the importance of those letters to the execution of his strategy from the start: As early as 2010, Lathen told Hood that he planned to conceal the Fund's role from issuers (PFOF¶780), acknowledging that issuers would not redeem under the SO if he provided all material facts to them. (PFOF¶¶416-18;423-28.)

Respondents' evidence showed only Lathen's general requests for a "comfort opinion" that his business was not illegal. (PFOF¶¶826;859.) Lathen testified that he was relying on his lawyers to tell him what the issues were. But that evidence is insufficient. "Good faith reliance on advice of counsel means more than simply supplying counsel with information....Compliance with federal securities laws cannot be avoided by simply retaining outside counsel to prepare required documents." SEC v. Enter. Solutions, Inc., 142 F.Supp.2d 561, 576 (S.D.N.Y. 2001) (internal quotations omitted); accord SEC v. AIC, Inc., 2013 WL 5134411, at *7-*8 (E.D. Tenn. Sept. 12, 2013) (rejecting advice-of-counsel defense where defendants offered no evidence of a specific request for advice). In Matter of Byron G. Borgardt, Rel. No. 33-8274, 2003 WL 22016313, at *11 (SEC Aug. 25, 2003), the Commission rejected the argument advanced by Respondents here—that they could "assume[] that [their lawyer] would alert them if he noted any legal problems or impediments posed by the Fund's business model."[6]

Flanders also testified that the Final Caramadre Memo was consistent with the advice that he had provided Lathen, meaning that he must have told Lathen that he should make full disclosure to all third parties. (PFOF¶832.)

[6] Taken at face value, Lathen's expectation that his lawyers would identify all issues raised by his business would shift responsibility to them to intuit his need for advice on aspects of which they may have neither knowledge nor expertise (e.g., PFOF¶849), a result inconsistent with the law.

The importance of asking for specific advice is underscored where the lawyer may opine that a strategy is legal, but is never asked for advice about its execution. For example, in Matter of Mohammed Riad, the Commission held that respondents' advice-of-counsel defense failed where they presented evidence of the lawyers' advice on Fund strategy, but none respecting investor disclosures:

> [The lawyers] did confirm to respondents that the Fund was *allowed* to trade in written put options or short variance swaps – *i.e.*, in the sense that these investments were not forbidden by the terms of the Fund's registration statement. But respondents neither sought nor received advice regarding the accuracy and sufficiency of the Fund's disclosures in the 2007 or May 2008 reports....

Rel. No. 34-78049A, 2016 WL 3627183, at *38 (SEC July 7, 2016), pet. filed, No. 16-1275 (D.C. Cir. Aug. 4, 2016) (emphasis in original); see also Borgardt, 2003 WL 22016313, at *11 (respondents could not claim that advice that arrangements were legal "meant that those arrangements did not have to be disclosed").

(3) Lathen Did Not Follow Advice He Obtained in Good Faith

(a) Lathen Did Not Rely on Advice He Received in Good Faith

The defense offers no protection for someone who "willfully and knowingly violate[s] the law, and [seeks to] excuse himself from the consequences thereof by pleading that he followed the advice of counsel." Williamson v. United States, 207 U.S. 425, 453 (1908). Where the client engages in conduct prior to seeking advice, he may not use subsequent advice to shield him. United States v. Scully, 170 F.Supp.3d 439, 449 (E.D.N.Y. 2016).

Respondents obtained advice as a shield for conduct they already knew was fraudulent. First, Lathen engaged in at least one transaction with a terminally-ill individual before approaching Katten for advice on the validity of his joint tenancies. (PFOF¶706.) And before Lathen opened the Fund, Katten warned him that regulators might not like his strategy, urged him not to finance it

by raising money from third-party investors, and declined to represent him in setting up a Fund. (PFOF¶¶683;685;692-93.) Nonetheless, he found a lawyer – Roper – who would draft the needed formation and offering documents for a low flat fee. (PFOF¶758.)

Second, Lathen understood that his strategy would succeed only if he concealed material facts from the issuers. From the start, Lathen saw his strategy as a "loophole," (PFOF¶1033) which, by definition, he could only exploit if the issuers did not know the complete truth about his relationship with Participants. (PFOF¶¶425;427;780-82.) Even had he received a legal opinion on his disclosure, he could not have relied on it in good faith in these circumstances. SEC v. Goldfield Deep Mines Co. of Nev., 758 F.2d 459, 467 (9th Cir. 1985) (company officer who knows filings are false or misleading cannot rely on unqualified opinion from accountant).

Third, Lathen knew that none of his lawyers who reviewed the Participant Agreements could find clear authority that his joint tenancies were valid. (PFOF¶¶827-30;868-69;893;898-99;1023.) And despite extensive efforts, he could not procure a legal opinion to that effect. (PFOF¶¶653;985-86;988-90.) Knowledge of such uncharted waters negates Lathen's attempt to rely on advice of counsel that his conduct was lawful, as the Commission has held:

> [Respondents] relied upon counsel's conclusion that they had discovered a loophole in the law of fiduciary responsibility. Counsel, in turn, relied upon the fact that no contested decision or rule was precisely in point and specifically prohibited respondents' scheme. This type of reliance is misplaced, particularly in the area of fraud. . . [B]oth counsel and clients were aware of the risk, and they can hardly claim that they could not reasonably foresee that the loophole which they perceived might prove to be illusory.

Lipper, 1975 WL 163472, at *8.

Fourth, despite knowing the shaky legal footing he was on, Lathen sought no advice about the IMA's impact on his joint tenancies until prospective investors asked for assurances about the

legality of his strategy; Lathen then put the question to Farrell.[7] (PFOF¶¶558-60.) Farrell confirmed what Lathen already knew—that Respondents' IMA destroyed the joint tenancies (PFOF¶¶871-76)—but Respondents continued to redeem securities in accounts governed by the IMA without any disclosure to issuers of its existence. (PFOF¶¶350-53.) That Farrell did not tell Lathen to stop those redemptions "expressly" (Tr. 2625:4-15) is irrelevant because Lathen already knew the redemptions were ineligible.

Fifth, by 2013, once Goldman Sachs first rejected his redemptions after reviewing his Participant Agreement, Lathen could no longer claim protection of advice of counsel in continuing to submit misleading redemptions. Goldman made clear to him that the Participant Agreement (at the least) was material to its eligibility determination and called his redemption requests a "scheme" involving representations that were "contrary to fact." (PFOF¶¶130;135;257; see also 1037.)[8]

Finally, in 2013, Lathen also became aware that the SEC sued two individuals for fraud for similar conduct, alleging they "failed to inform the brokerage firms or bond issuers that the deceased Program participants had signed the Estate Assistance Agreements and Participant Letters relinquishing all ownership in the bonds." (PFOF¶449.) While Lathen could have (and

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[7] Gersten Savage did no research on the validity of the joint tenancies, nor did they advise Lathen on the topic. (PFOF¶751.) Nor can Lathen claim that Roper unilaterally decided on the nominee structure without explaining it. In an October 2010 investor presentation – prior to Roper's work on the IMA – Lathen described a "nominee agreement" between himself and the Fund. (PFOF¶¶763-64;1024.)

[8] Thereafter, Lathen received a steady stream of issuer correspondence (and a lawsuit) rejecting his redemptions after review of his Participant Agreements, and accusing him of fraud. (See PFOF¶¶162-68;200;239-246;256;258.)

apparently did) distinguish his Participant Agreements from the Staples',[9] he then understood that the Commission viewed a failure to disclose such side agreements as fraudulent.

Once Lathen became aware that others—including the Commission—viewed disclosures to issuers like his as materially misleading, no advice he obtained could mitigate his scienter in continuing to submit his misleading redemption letters. Lipper, 1975 WL 163472, at *8 (client's reliance on attorney's advice was unreasonable where attorney advised that Commission's position was wrong); accord Scully, 170 F. Supp. 3d at 449 (where client received conflicting opinions from FDA regarding legality of conduct, he could not reasonably rely on advice of counsel that conduct was lawful).

Of course, even if Lathen could point to advice that his redemption letters were not misleading, any reliance on it would have been unreasonable given his background. While securities professionals "cannot necessarily be expected to display finished scholarship in all of the fine points of the securities laws, the duty not to mislead . . . and to provide . . . material information is fundamental." Riad, 2016 WL 3627183, at *38 (quotations omitted). Lathen's long tenure in the securities industry, where he apparently earned a reputation for thoroughness and intelligence (PFOF¶¶28-29), means that he understood his obligation to fully disclose the nature of his arrangement to issuers.

(b) Lathen Ignored Advice He Disliked

Good faith reliance on advice of counsel requires that the respondent follows the advice he receives. On countless occasions, Lathen ignored advice from his counsel, often concealing that he was doing so.

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[9] That Lathen distinguished himself from the Staples by arguing that his Participant Agreements were different (PFOF¶450) only proves that he viewed the Participant Agreements as material to a determination of the validity of his arrangement, yet continued to hide them from issuers. (See DRRPFOF¶156; PFOF¶¶481;957.)

Katten's Tractenberg told Lathen that in a valid joint tenancy under New York law, each Participant would have a one-third interest in the joint accounts, but Lathen prepared a Participant Agreement that stripped them of their interest in the accounts. (PFOF¶¶704;707.) Tractenberg advised Lathen that the joint tenancies would produce gift tax obligations because he was gifting the moiety to the Participants, but Lathen paid no gift tax. (PFOF¶¶291;709-11; see also ¶¶345;371.) Katten told Lathen not "to go out and become a hedge fund and start selling securities to other people" (PFOF¶693), but that is exactly what he did.

According to Lathen, Roper advised him on a form of Participant Agreement. While Roper could not recall doing so (PFOF¶1019), Lathen testified that Roper had revised the Participant Agreement in a way that Lathen thought incorrect, so Lathen changed it himself. (PFOF¶1018; see also ¶750.)[10]

Lathen disregarded Hood's 2014 advice that all income from the accounts under the loan structure would be taxable as ordinary income, advice he had already received from Farrell. (PFOF¶¶808-12;912.) Even if Lathen received contrary advice from auditors—a claim supported only by Lathen's self-serving, unsubstantiated testimony (PFOF¶556)—a client may not assert reasonable reliance on only the advice that he likes best. In re Wyly, 552 B.R. 338, 494 (N.D. Tex. 2016).

Lathen disregarded "unfavorable" advice from Farrell on numerous occasions. Despite the fact that she advised him that Respondents' IMA destroyed his joint tenancies (PFOF¶¶871-76), Lathen continued to redeem bonds held in accounts governed by the IMA for years. (PFOF¶¶351-53.) And although he understood that Farrell believed the PSA suffered from similar deficiencies

[10] Notwithstanding his view that that Participant Agreement—prohibiting James McCord from the "exercise any right of ownership" (PFOF¶333)—stripped McCord of the necessary beneficial ownership in the joint account, Lathen nonetheless redeemed at least 12 different SO bonds in that account without disclosure that the joint tenancy was invalid. (PFOF¶¶342-43.)

(2) Respondents Ignore Rules 10b-5(a) and (c) or Section 17(a) to Which Janus Does Not Apply

Respondents' arguments against liability for anti-fraud violations focus solely on Rule 10b-5(b)'s prohibition against "false statements," ignoring the Division's claims under Rule 10b-5(a) and (c) and Securities Act Section 17(a), which include non-statement deceptive conduct. Janus does not bar claims under Section 17(a) or Rules 10b-5(a) and (c) against scheme participants who further the fraud through non-misstatement fraudulent conduct; because Janus interprets the term "make," its holding has no application to those subsections of Rule 10b-5 and Section 17(a) that do not contain that term. See SEC v. Big Apple Consulting USA, Inc., 783 F.3d 786, 796-98 (11th Cir. 2015) (declining to apply Janus to Commission's claims under Section 17(a)) (collecting cases); Matter of Dennis J. Malouf, Rel. No. 33-10115, 2016 WL 4035575, at *9 (SEC July 27, 2016), pet. filed, No. 16-9546 (10th Cir. Sept. 8, 2016) (holding that Janus does not apply to Rule 10b-5(a) or (c) or Section 17(a)(1) and (3) claims against drafter of false statements who had not signed them).

As noted in our moving brief, Respondents are liable as primary actors because each engaged in their own acts of deceptive conduct in furtherance of Lathen's fraudulent scheme. (DPHB at 16-17.)

C. Respondents' Falsity Arguments Ignore the Law

In arguing that Lathen had no duty of "additional disclosure beyond the statements made" (RPHB at 8-9), Respondents ignore their securities law obligations. Their duty to disclose was not defined as a matter of contract by the prospectuses. (Id. at 9-10.) To the contrary, the federal securities laws seek to "substitute a philosophy of full disclosure for the philosophy of caveat emptor" that applies under contract law. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963). Thus, whatever the prospectuses required Respondents to disclose, Respondents

had an independent duty to make it complete and accurate, as Lathen's lawyers advised him from the start. (PFOF¶¶741-42;889-92.) Because Respondents told issuers that Lathen and the Participants were "owners" or "beneficial owners" of the bonds, they were required to provide the additional and material information that bore upon that claim, irrespective of their obligations under the contract/prospectus. That was their duty to speak under the securities laws. Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 47 (2011) (RPHB at 9) (defendant had duty to disclose risks as "material facts 'necessary in order to make the statements made . . . not misleading'").

That duty to speak fully cannot be limited by contract, as Respondents suggest. (RPHB at 16 (urging the Court to confine its analysis to the "four corners" of the prospectuses).) A respondent is liable for fraudulent material omissions irrespective of what his counter-party requests. Any other rule would shift the burden to counterparties to imagine all possible fraudulent schemes, an impossible task because "[f]raudulent practices constantly vary, and practices legitimate for some purposes may be turned to illegitimate and fraudulent means." Chadbourne & Parke LLP v. Troice, 134 S.Ct. 1058, 1078 (2014) (quotations omitted); see also Superintendent of Ins. of NY v. Bankers Life & Cas. Co., 404 U.S. 6, 11 n.7 (1971) ("Novel or atypical [fraudulent] methods should not provide immunity from securities laws.") (internal quotations omitted).

For these reasons, in VanCook v. SEC, the Second Circuit held that a defendant's communications with a mutual fund, which he claimed comported with prospectus requirements, were materially misleading as implied misrepresentations. 653 F.3d 130, 141 (2d Cir. 2011). There, like here, the defendant thought he had identified a "loophole"—he could accept orders to buy mutual fund shares prior to the cutoff set by the funds' prospectuses, but still allow customers to affirm or "bust" those trades after the cut-off based on after-market information. Id. at 133-34. The Second Circuit concluded that the defendant's submission to the mutual funds of the post-

(PFOF¶¶905-09), he continued to redeem securities held in accounts governed by that agreement, and failed to disclose her advice when consulting Galbraith. (PFOF¶1011.)

Other advice Lathen discarded from Farrell includes: (1) Farrell's advice to stop moving funds and securities among the joint accounts (PFOF¶¶933-37); (2) Farrell's admonition to implement an Account Control Agreement like the one she provided (PFOF¶¶925-28); and Farrell's warning that he would be subject to claims of fraudulent representations if he continued to falsely tout the charitable contributions EndCare would make on Participants' behalf. (PFOF¶¶582;882-884.)

Lathen even disregarded Galbraith's advice. Although Galbraith recommended that he spell out that Participants held a 50% interest in the JTWROS accounts in the Participant Agreements, Lathen rejected it, notwithstanding his claim now that Participants enjoyed that level of ownership. (PFOF¶¶345;1014.)

B. *Janus* Does Not Foreclose Respondents' Liability

(1) Lathen and EACM Made False Statements to Issuers

As Respondents concede, Lathen signed numerous false statements that were, as he expected, included as part of the redemption packages forwarded by his brokers to the issuers. (RPHB at 4 (acknowledging that redemption packages included redemption letters); 5 (same), 6 ("Lathen simply submitted a redemption request").)[11] That is sufficient to establish Lathen's "maker" status under Janus. Janus Capital Grp. v. First Derivative Traders, 564 U.S. 135, 147 n.11 (2011) ("it does not matter whether the statement was communicated directly or indirectly to the recipient").

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[11] "RPHB" refers to Respondents' May 5, 2017 Post-Hearing Brief. "DPHB" refers to the Division's April 7, 2017 Post-Hearing Brief.

Contrary to Respondents' attempt to distinguish the Division's authority (DPHB at 15) the Division's cases did involve "two entities or individuals"—entities and individuals that were, like Lathen and the brokers here, engaged in agency relationships. Dembski, 2017 WL 1103685, at *7 (lawyer incorporating false statement of client); Matter of S.W. Hatfield, Rel. No. 34-73763, 2014 WL 6850921, at *6 (client incorporating false statements of auditor). And Respondents overlook SEC v. Pentagon Capital Mgmt. PLC, 725 F.3d 279, 286-87 (2d Cir. 2013) (DPHB at 15), a case that also involved a broker and his customer. Just as the court did there, this Court should reject Respondents' argument that Janus precludes liability since the broker, not they, conveyed the false statements. Id. at 286-87.

Also unavailing is Respondents' argument that the brokers' identification of the account holders was the material statement at issue here. (RPHB at 5; 16 ("only title at the brokerage firm is relevant under Issuers' governing documents for purposes of establishing beneficial ownership").) Issuer testimony and evidence establish that "beneficial owner" was not synonymous with the titled owner on the account. (PFOF¶¶106;109;111-12; see also PFOF¶¶86;108.) If the account holder is necessarily the beneficial owner, issuers would have no need for a representation by Lathen; the account statements would provide the necessary evidence. But Respondents concede that all issuers required their redemption letter. (RPHB at 4.)[12] Lathen himself understood the difference, acknowledging contemporaneously that the deceased had to have a beneficial interest in the accounts to be eligible for redemption. (PFOF¶¶420;847.)

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[12] Respondents' brand-new claim that Lathen's redemption letters were not part of the packages sent to the issuers (RPHB at n.5), is refuted by the redemption packages and Lathen's and Robinson's testimony. (PFOF¶¶173;401-404.)

close confirmed orders "constitutes an implied misrepresentation" that he had received the orders prior to the close. Id. at 140-41.[13] This deception— "[making] it appear" that defendant's trades complied with the mutual funds' stated requirements—in fact violated the prospectuses' requirement that trades be executed by 4:00 p.m. in order to receive that day's price. Id. at 140. Accord SEC v. Pentagon Capital Mgmt. PLC, 725 F.3d 279, 286 (2d Cir. 2013) (similar late-trading scheme violated Exchange Act 10(b) and Securities Act 17(a)).

Respondents' exploitation of the "loophole" they claimed they had found required the same kind of deception. Respondents had to "make it appear" that Lathen and Participants were beneficial owners of the SO instruments, as the prospectuses required, when the Fund was the true owner. Thus, irrespective of what the prospectuses required, Respondents' statements were materially misleading.

D. Respondents' Misleading Statements Were Material

Contrary to Respondents' current contention (RPHB at 15), issuer after issuer testified that Lathen's arrangements with the Participants and the Fund were (in GECC's words) "critical" to their determination of Respondents' eligibility to redeem. (PFOF¶124; see also¶¶116-23;125-26;130-34;138;142;160-63;165;167;171;178-82;200;228;230;239-41;243;245;1037.)[14]

Faced with this consistent testimony, Respondents point to evidence that certain CD issuers (whom Respondents did not call to testify) agreed to pay, and unreliable circumstantial evidence

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[13] Presumably, the mutual funds in VanCook could have anticipated defendant's fraud and prescribed in their Prospectuses that buyers submit all details of their order submissions. But the fact that they did not did not render VanCook's conduct any less deceptive.

[14] Respondents contend that no issuer "relied" on Lathen's statements. (E.g., RPHB at 15.) Reliance is not an element of the Division's claims and is irrelevant. Malouf, 2016 WL 4035575, at *10.

about why they did.[15] (RPHB at 17 (citing Barclays, CIT and BMO).) That evidence does not refute materiality, as Lathen's own lawyer conceded, (PFOF¶1106), because each of them agreed to pay after Lathen or Galbraith threatened to sue them (PFOF¶¶253-55;609;1004-06) and none had seen the IMA or PSA.[16] (PFOF¶¶413-14.)

Lathen's December 2015 revised redemption letter—evidence that he knew his earlier versions were materially misleading—did not make the issuers any more informed.[17] (RPHB at 17.) As Goldman Sachs' Begelman testified, Lathen's notification that there were side agreements did nothing to disclose the terms of those agreements or what their effect was on beneficial ownership. (PFOF¶415.) Matter of Richmark Capital Corp., Rel. No. 34-48758, 2003 WL 22570712, at *8 (SEC Nov. 7, 2003), aff'd, 86 F. App'x 744 (5th Cir. 2004) (disclosure of existence of relationship did not provide meaningful disclosure of its terms).

Finally, materiality is judged according to an objective standard. (DPHB at 7.) Objectively, the testimony and evidence supplied by the Division at the hearing overwhelms the limited evidence mustered by Respondents that some issuers, either ignorant of the facts or threatened with lawsuit, or both, were willing to pay Respondents' redemptions.[18]

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[15] Respondents concede that CD disclosure statements are different from bond prospectuses. (PFOF¶¶39;41;420.) CDs are not at issue in this matter.

[16] Respondents' citations to issuer declarations given in the Division's Staples investigation (RPHB at 17 (citing RPFOF¶187); RPFOF¶186), and to the Brady letters (RPFOF¶¶170;184-88) are improper because the Court ruled that that evidence was not admissible for "the truth of the assertions in the documents." (Tr. at 3703:22-23; see also March 2, 2017 Letter from Division to the Court.) Respondents could have called these issuers at the hearing, but did not.

[17] The vast majority of redemptions that Lathen submitted using this letter were with respect to CDs. (PFOF¶411.)

[18] Which issuers redeemed the most is irrelevant to materiality. (RPHB at 17.) That some issuers (like Goldman, GECC and Federal Farm) were able to protect themselves by rejecting Respondents' redemptions when they discovered at least some part of Respondents' deception does not make them less qualified to attest to materiality than those who never learned of the fraud and kept paying.

E. Respondents' Fraud Was in Connection with the Sale, and in the Offer or Sale, of Bonds

Respondents offer cases interpreting IRS rules and regulations to argue that no sale of securities is involved in a bond redemption, (RPHB at 18)—cases that have no application in this securities case. The only non-tax case they cite is one interpreting "sale" under Section 17(a) of the Investment Company Act, a statute not involved here. Id. (citing SEC v. Sterling Precision Corp., 393 F.2d 214, 217 (2d Cir. 1968)). They ignore the Second Circuit's later determination in Drachman v. Harvey, 453 F.2d 722, 737 & n.2 (2d Cir. 1971) (en banc), that a redemption of convertible debentures does satisfy the purchase or sale requirement of Section 10(b), and distinguishing Sterling Precision as confined to the narrower Investment Company Act Section 17(a).[19] See also SEC v. Wealth Strategies Partners, LC, 2015 WL 3603621, at *7 (M.D. Fla. June 5, 2012) (redemptions satisfy "sale" and "offer" within the meaning of Exchange Act Section 10(b) and Securities Act Section 17(a)).

F. Respondents Acted Negligently in Violating Sections 17(a)(2) and (3)

The record establishes Respondents' negligent violations of violated Sections 17(a)(2) and (3). Lathen testified to the applicable industry standards of care—honesty, integrity and professionalism—which were imposed by EACM's Code of Ethics. (PFOF¶11.) That he routinely fell far short of those standards by concealing the Participant and Fund Agreements from issuers (PFOF¶¶413-14), deflecting issuer requests for additional information (PFOF¶¶157;218), and lying in response to questions from issuers and his own lawyer (PFOF¶¶159;610-11), establishes his negligence, which is imputed to EACA and EACM.[20]

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[19] Unlike Section 17(a) of the Securities Act, Section 17(a) of the Investment Company Act does not even include the word "offer," making Sterling Precision even less relevant.

[20] Lathen also caused EACM's violations of the Custody Rule. As Grundstein testified, a CCO's number one priority is to ensure the Adviser's strict compliance with rules and

G. Respondents' Arguments Regarding Joint Tenancies Are Irrelevant

(1) Respondents Knowingly Set up Invalid Joint Tenancies

Respondents' contention that the JTWROS accounts Lathen set up with Participants were valid, and therefore the Participants were beneficial owners of the SO securities, is wrong. Participants were not beneficial owners of the securities—they held neither the economic privileges nor risks associated with the SO bonds, requirements for redemption under the various Prospectuses. (See DPHB at 2-7.) That ends the query.

But it is also wrong because Lathen's joint tenancies were invalid. The Fund—not Lathen, not Participants—was the true owner of the assets in the joint tenant accounts, and as explicitly stated in the IMA, Lathen was a nominee for the Fund. But an entity cannot be a joint tenant under New York law. Island Fed'l Credit Union v. Smith, 60 A.D.3d 730, 732 (2d Dep't 2009). The joint tenancies were invalid for that simple fact.

Lathen knew this in 2010, which caused his dilemma: the Fund could not be the owner in joint tenancy under New York law yet the Fund had to be the owner to provide security to investors and qualify the income for capital gains treatment. (PFOF¶¶42;358;776-78.) He resolved this by checking a JTWROS box on an account opening form, which he knew was misleading. Respondents knew from the outset that the bonds were not held in true joint tenancy and their redemptions were materially misleading. Any argument about the permissibility of side agreements under NY Banking Law § 675 is irrelevant.

What Lathen knew in 2010 was confirmed in 2012 when Farrell explained that both the Participant Agreement and the IMA undermined the validity of his joint tenancies. (PFOF¶¶871-72.) The same was true of the PSA (as Farrell explained), which, by forming a partnership

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regulations. (PFOF¶¶724-27.) Lathen did not comply with those obligations, and testified that he assigned compliance to others. (PFOF¶553.)

between Lathen and the Fund and funneling all profits to the Fund (PFOF¶¶170;374-75), again rendered the Fund a co-tenant and destroyed the joint tenancy. (PFOF¶¶909;911.)

(2) Respondents' Caselaw Does Not Require a Different Result

The cases relied upon by Respondents do not change this result. (RPHB at 12-13.) None involved the facts here, where the two "joint tenants" held the account as a front, to hide the fact that the beneficial owner was a third party who could not be a valid account holder under the law. Contrary to Respondents' argument, the caselaw and evidence confirm that the parties had an intention to create an account for the convenience of Lathen and not with the intention to form a true joint tenancy.[21]

Both Estate of Corcoran, 63 A.D.3d 93 (3d Dep't 2009) and Estate of Farrar, 129 A.D.3d 1263 (3d Dep't 2015) (RPHB at 12-13), undercut Respondents' position. In those cases, the court held that the co-tenant's view of the arrangement was probative of the parties' intent to create a convenience account as opposed to a true JTWROS. Corcoran called the "conduct and statements of a surviving cotenant" a "major factor" in determining the parties' intent. Corcoran, 63 A.D.3d at 97 (jury question on validity of joint tenancy where survivor received no account statements, never withdrew funds and considered the account to be the decedent's); Farrar, 129 A.D.3d at 1264

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[21] Both joint tenants must have the intention to create a joint tenancy for the legal status to be valid. See Banking Law § 675 (discussing the intention of both depositors). That is, they must intend to share "equal rights...in its enjoyment during their lives, and creating in each joint tenant a right of survivorship." Goetz v. Slobey, 76 A.D.3d 954, 956 (2d Dep't 2010); see also Smith v. Bank of America, N.A., 103 A.D.3d 21, 24 (2d Dep't 2012); Fischedick v. Heitman, 267 A.D.2d 592 (3d Dep't 1999); Estate of Zecca, 152 A.D.2d 830, 830-1 (3d Dep't 1989). The parties here had unequal rights to access the accounts, to transfer funds into and out of the accounts, to share in the profits of the accounts during their lifetimes, and to the passage of the assets upon death, evidencing that the requisite intent to create equal rights to the accounts was not present. (PFOF¶¶260;273-75;277;282-87;296-97;302-307;310-312;315;317-18;320;322-329;359-61;1025-29.) At least four sets of issuer and trustee lawyers, who analyzed New York law and the limited facts before them, concluded the joint tenancies were invalid, and told Lathen so. (PFOF¶¶135;142;146;163;165;167;200;239-241;243;245;1034-1038.)

n.5 (no joint tenancy where, after decedent's death, survivor transmitted account funds to decedent's executor for inclusion in estate, and during decedent's life did not receive account statements or have significant involvement with account). Jungbauer, Lathen's co-tenant with many of the Participants, testified that he "never had any financial interest in the accounts." (PFOF¶¶360.)[22] Nor, as the testimony showed, did Lathen, Jungbauer or Participants have expectations of equal survivorship rights; when Davis was cured of cancer, Lathen transferred the money out of her account, closed it and sent Davis none of the proceeds. (PFOF¶¶320;325-27;359;364.)

Estate of Stalter, 270 A.D.2d 594 (3d Dep't 2000) (RPHB at 13), equally undermines Respondents' arguments. The Stalter court determined that an undated letter was insufficient evidence that the parties intended a convenience account at the time a JTWROS account was opened. But "[h]ad the letter been authored shortly after the account was opened," it "would be probative on the issue of decedent's intent to create a joint tenancy with a right of survivorship" at the time the account was established. Id. at 596. No such mystery exists here. All the pertinent agreements were signed *before* the JTWROS accounts were opened. The parties' intent at the time of opening is clear—and it was not to create a true joint tenancy.

Matter of Grancaric, 91 A.D.3d 1104 (3d Dep't 2012) (RPHB at 13) is similarly unhelpful. There, the court upheld a joint tenancy because there was no evidence that either co-tenant

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[22] Davis and Alamo testified to a similar understanding. Davis understood that "they were going to give me $10,000 for me to do what I wanted to do." (PFOF¶320.) And neither she nor Alamo received account statements, online access to, or profits from the accounts nor any withdrawal rights without permission. (PFOF¶¶302-07;310-311;317;318;320.) Robinson told government entities that Davis "will not receive any additional payments from us now or in the future" (PFOF¶324) and told Participants that: "You're getting $10,000 and full stop." (PFOF¶273.) And all Participants understood this from the EndCare brochure: "Financial assistance comes in the form of a one-time cash payment made within 15 business days of enrollment." (PFOF¶274.)

believed the account was set up for his own convenience, even though it may have been set up for the convenience of a third-party who had deposited the funds. Id. at 1105-6. To the contrary, here, Lathen's joint tenancies were set up for Lathen's convenience. Without them, he could not exercise the strategy at all. In any event, the Participant and Fund agreements documenting that Lathen had "no beneficial interest" in the account investments (PFOF¶357), and Participants' interests were (at best) *de minimus*, along with the testimony that Participants and Jungbauer did not believe they were equal co-tenants, all make this case a far cry from Grancaric, where "[a]bsolutely no evidence exist[ed]" of a convenience account. 91 A.D. 3d at 1106; see also Farrar, 129 A.D.3d at 1264 n.5.

Lathen and the Participants did not intend to create true joint tenancies. They could not have had equal rights to the accounts because, in the words of Galbraith, "[t]he strategy doesn't work if the participant empties the account the day after the account is set up and funded." (PFOF¶997; see also PFOF¶¶259;345;371;590;1014.) And, as Lathen knew, none of the cases upon which he relied—then or now—is "factually on all fours with the investment strategy," where two straw-men act as the face of an account in which a third-party entity held the beneficial interest. (PFOF¶1023; see also PFOF¶¶829;869.)

II. RESPONDENTS' CUSTODY RULE ARGUMENTS ARE REFUTED BY THE EVIDENCE

The Division respectfully refers the Court to its argument and the cited evidence included in its opening Brief. (DPHB at 19-26.) Respondents offer nothing to refute the evidence that EACM violated the Custody Rule and Lathen offered knowing (or at least reckless) substantial assistance to that violation.

III. RESPONDENTS IGNORE THE DIVISION'S REMEDIES ANALYSIS AND WAIVED THEIR INABILITY TO PAY AFFIRMATIVE DEFENSE

Respondents offer no argument against the remedies the Division seeks. They do not contest that the Steadman factors support the imposition of a cease-and-desist order, industry bars, disgorgement, and penalties. (DPHB at 26-30.) Nor do they challenge the Division's disgorgement, prejudgment interest, and penalty calculations. (Id. at App'x B and C.)

Further, Respondents have waived their inability to pay affirmative defense by offering no evidence or argument in support, either at the hearing or in briefing. Respondents bear the burden of establishing inability to pay and must introduce sufficient documentary evidence of their financial condition. Matter of Gregory O. Trautman, Rel. No. 33-9088A; 2009 WL 6761741, at *24 & n.113 (SEC Dec. 15, 2009) (rejecting inability to pay defense where respondent failed to submit financial disclosure); Matter of Terry T. Steen, Rel. No. 34-40055, 1998 WL 278994, at *6 (SEC June 2, 1998) (offer of one financial exhibit failed to satisfy respondent's evidentiary burden under Rule of Practice 630(b)). Here, Respondents—who never entered Lathen's Financial Disclosure into evidence—adduced no documentary evidence of their financial condition. Nor do they offer any argument in their briefing. Having failed to do so, Respondents waived the defense, and the Court should not consider it.[23]

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[23] In any event, inability to pay is "only one factor" as to whether disgorgement, prejudgment interest or penalty should be imposed, and "is not dispositive." Trautman, 2009 WL 6761741, at *24; see also Matter of Edgar R. Page, Rel. No. IA-4400, 2016 WL 3030845, at *15 & n.92 (SEC May 27, 2016) (rejecting inability to pay argument in part because it stemmed from Respondent's "spending on luxury items," "profligate spending" and loans to children); Malouf, 2016 WL 4035575, at *28 (imposing penalty for fraudulent conduct, despite Respondent's claims of inability to pay).

CONCLUSION

For the foregoing reasons, and based on the entire record herein, the Division respectfully requests that the Court find that Respondents have violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, Securities Act Section 17(a), Advisers Act Section 206(4) and Rule 206(4)-2 thereunder, and impose appropriate sanctions as detailed in its brief dated April 7, 2017.

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New York, New York

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